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Financial Statements - U.S. GAAP to IFRS: Understanding the Change in Financial Ratios for Creditors and Investors with the Convergence from U.S. GAAP to IFRS

Kate McCarthy
University of Redlands

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Executive Summary

Through factual research and company analysis, this paper will be examining the effects that a convergence among United States Generally Accepted Accounting Principles and International Financial Reporting Standards will have on creditors and investors through not only the assessment of the differences between the ratios that are used to make loans or investments, but of how the composition of these ratios will change. The goal of this paper, being divided into various chapters, is to add to the understanding of how a convergence between U.S. GAAP and IFRS will affect the way creditors assess the financial positions of companies in order to make a loan to them, and how their criteria to loan or invest will change with the convergence.

The first chapter will provide fundamental insight into the background of IFRS, what the benefits entail and who will be required to adopt these standards. The second chapter will provide a basic overview of the use of financial statements during the process of making a bank loan, and the criteria creditors and investors use to make those loan and investment decisions under U.S. GAAP. The third chapter will examine significant, important changes to the income, balance sheet and equity accounts that will be affected by the convergence to IFRS, and why external users should be weary of these adjustments. Within chapter four will be a theoretical approach to the differences that ratios will have when reconciled between IFRS and U.S. GAAP, and how creditors and investors will react to these differences. A numerical analysis of the impact on individual companies will be discussed and examined in this chapter as well. The fifth chapter will provide more in-depth analysis of selected companies from the previous chapter, where necessary, to provide more clarity or investigative analysis about questionable areas

uncovered. Lastly, the sixth chapter acts to tie together the entire paper and provide concluding results.

Chapter #1
Background and Benefits of International Financial Reporting Standards

The Goal of Achieving a Uniform Set of Accounting Standards

As a result of today's ever increasing globalization of business, investors and creditors are always searching the markets for company comparisons to one another and looking for trends in industries to help increase their decision making abilities. Although accounting is the language of business and aides in these processes, the language barrier between U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) can sometimes lead external users to incorrect conclusions. In order to enhance the ability to compare financial information of U.S. and non-U.S. companies, the Securities and Exchange Commission (SEC) has proposed the required use of International Financial Reporting Standards. The conversion will not only directly impact various reporting standards currently used under GAAP, but, more specific to creditors and investors, will affect ratios that are used in the analysis of a company. Through a theoretical and analytical approach, the affect of these changes in ratios will be discussed for both sets of external users. Since the road to IFRS is focused, for all U.S. publicly traded companies, to end around 2015, businesses across the nation are already beginning to prepare for this transition.

The United States is one of the world's most influential economies that does not use International Financial Reporting Standards. Instead, publicly traded companies are required to use a more rules based system of accounting known as U.S. GAAP. However, the SEC, who oversees publicly traded companies in the U.S., is pushing for firms to switch to IFRS, in hopes of attaining more unity among nations. The SEC has recently let U.S. companies choose for themselves whether they would like to use U.S. GAAP or IFRS, but it may soon be mandatory. The convergence to IFRS will make the U.S. more competitive in a continually globalizing economy by providing investors and creditors around the world with the quality and consistency of financial reporting that they need, and should rightly expect.

Although a date has not yet been set for when IFRS will have to be implemented, the only companies who will be mandated to do so will be U.S. publicly traded companies. That is it not to say that many privately held companies would choose not to apply the international standards as well; after all, the goal of converging to IFRS is to create a single set of accounting standards for all businesses to use. As an example, many privately held companies adopted provisions of the not mandatory Sarbanes-Oxley Act, such as the formation of independent audit committees, and thus they might take similar action regarding IFRS. On December 17, 2009, the American Institute of Certified Public Accountants (AICPA), who sets ethical standards for the profession and U.S. auditing standards, the Financial Accounting Foundation (FAF), which is the independent, private-sector organization with responsibility for establishing and improving accounting and reporting standards and the National Association of State Boards of Accountancy (NASBA), who addresses the issue of ethics and ethical behavior in business, announced the establishment of a blue-ribbon panel to address how U.S. accounting standards can best meet the needs of users of private company financial statements.[1] The panel will provide recommendations on the future of standard setting for private companies, including whether separate accounting standards for private companies are needed; however the details of such discussion are out of the scope of this paper. The panel's report is expected in the early part of 2011.

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[1] "FAQ Page." International Financial Reporting Standards. November 15, 2010. http://www.ifrs.com/ifrs_faqs.html#q16.

For many years, the SEC has been expressing its support for a core set of accounting standards that could serve as a framework for financial reporting throughout the world. On February 24, 2010, the SEC issued release Numbers 33-9109 and 34-61578, *Commission Statement in Support of Convergence and Global Accounting Standards*, in which the SEC stated its continued belief that a single set of high quality, globally accepted accounting standards would benefit U.S. investors[2]. The release also called for the development of a "Work Plan" in order to enhance both the understanding of the SEC's purpose and public transparency in this area. Execution of the Work Plan, combined with the completion of previously agreed upon convergence projects between the FASB and IASB, who develops international financial reporting standards, according to their current schedule, will permit the SEC to make a determination, in 2011, regarding incorporating IFRS into the financial reporting system for U.S. issuers. The SEC made clear that it envisions 2015 as the earliest possible date for the required use of IFRS by U.S. public companies.[3]

Costs and Benefits of Converging to International Financial Reporting Standards

By adopting IFRS, a business can present its financial statements on the same basis as its foreign competitors, making comparisons for external users both easier and more beneficial. Furthermore, companies with subsidiaries in countries that require or permit IFRS may be able to use one accounting language company-wide, thus saving time on translating financials from one system to another and creating less opportunity for error

[2] "FASB Home Page." Financial Accounting Foundation. November 14, 2010. http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FNewsPage&cid=1176156667603.

[3] "FAQ Page." International Financial Reporting Standards. November 15, 2010. http://www.ifrs.com/ifrs_faqs.html#q16.

as well. On the same thought, companies may need to convert to IFRS if they are a subsidiary of a foreign company that must use IFRS, or if they have a foreign investor that uses IFRS. Companies may additionally benefit by using IFRS if they wish to raise capital abroad. On the other hand, others believe that U.S. GAAP is the gold standard, and a certain level of quality will be lost with full acceptance of IFRS. Moreover, certain U.S. companies without significant customers or operations outside the United States may resist IFRS because they may not have a market incentive to prepare IFRS financial statements. By doing a simple cost versus benefit analysis, these companies find that the significant costs associated with adopting IFRS outweigh the benefits. Even though theses costs would be determined largely by the size and nature of the company, it will be costly for any company to change their standards. The AICPA believes the initial cost to identify and quantify the differences between U.S. GAAP and IFRS would include staff training and implementing IT support which could be significant, but the conversion also could result in an ultimate reduction of costs for capital and financial reporting related to operations.[4] These benefits are undeterminable currently and will remain so until actual attempts are made to converge in later years. In its proposed roadmap to move all U.S. publicly traded companies to the global standards issued in November 2008, the Securities and Exchange Commission estimated that the largest U.S. registrants that adopt IFRS early would incur about $32 million per company in additional costs for their first IFRS-prepared annual reports, and that the average U.S. company would incur costs of between 0.125% to 0.13% of revenue.[5]

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[4] "FAQ Page." International Financial Reporting Standards. November 15, 2010. http://www.ifrs.com/ifrs_faqs.html#q16.

[5] IBID

An additional issue to consider about changing to IFRS is the difference between the SEC specifying that companies must *adopt* or *converge*. Adoption would mean that the SEC sets a specific timetable when publicly listed companies would be required to use IFRS as issued by the IASB. Convergence means that the U.S. FASB and the IASB would continue working together to developing high quality, compatible accounting standards over time. More convergence will make adoption easier, less costly and may possibly even make adoption of IFRS unnecessary. Supporters of adoption, however, believe that convergence alone will never eliminate all of the differences between the two sets of standards so the adoption may as well take place sooner rather than later.

The biggest difference between U.S. GAAP and IFRS is that IFRS is more principles based and provides much less detail, leaving many standards vulnerable to management's interpretations. In the Proposed Roadmap, the SEC stated that "IFRS...in certain areas permits a greater amount of options than in U.S. GAAP...[This] greater optionality in IFRS could reduce comparability of reported financial information, as different issuers may account or provide disclosure for similar transactions or events in different ways[,] but this flexibility also allows a financial statement that may more closely reflect the economics of transactions."[6] IFRS also contains relatively little industry-specific instructions. With the continual convergence projects between the IASB and the FASB, the extent of the specific differences between IFRS and GAAP has been shrinking. So far considerable differences do remain, any of which can result in significantly different reported results, depending on a company's industry and specific

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[6] Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers, Release No. 33-8982 (November 14, 2008) [73 FR 70816 (November 21, 2008)] ("Proposed Roadmap").

circumstances. Some examples of differences are: IFRS does not permit Last In, First Out (LIFO), IFRS uses a single-step method for impairment write-downs rather than the two-step method used in U.S. GAAP, thus making write-downs more likely and IFRS does not permit debt, for which a covenant violation has occurred, to be classified as non-current unless a lender waiver is obtained before the balance sheet date.[7] More specific examples of differences between IFRS and U.S. GAAP will be explored in a later chapter pertaining more to creditors and investors.

Conversion to IFRS is much more than an accounting exercise. It will affect many aspects of a U.S. company's operations, ranging from information technology systems and tax reporting requirements, to internal reporting and key performance metrics and the tracking of stock-based compensation. As IFRS grows in acceptance, most CPAs, financial statement preparers and auditors will have to become knowledgeable about the new rules. Also, others, such as actuaries and valuation experts who are engaged by management to assist in measuring certain assets and liabilities, are not currently taught IFRS and will have to undertake comprehensive training. Professional associations and industry groups have begun to integrate IFRS into their training materials, publications, testing, and certification programs; as well as many colleges and universities including IFRS in their curricula.

How International Financial Reporting Standards Affects Auditors

The main question facing the PCAOB currently is how the auditors would react if all companies filing on U.S. exchanges were allowed to use International Financial

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[7] "FAQ Page." International Financial Reporting Standards. November 15, 2010. http://www.ifrs.com/ifrs_faqs.html#q16.

Reporting Standards, and how the auditors would get the proper training. Since the U.S. is not the only country that has been faced with this convergence, the best way to speculate how the U.S. will be affected is to see how previous countries and their auditors dealt with the change. When Canada began their convergence process in 2008, it proved to be no easy task. In the beginning, the audit committees began thinking about this transition to IFRS, the potential impact on the enterprise as well as its financial reporting and what issues the committee needed to consider in providing its oversight. According to KPMG in Canada, the audit committees focused on: Management's plan for transition, Impact on management reporting, operating and control systems, Implications for audit committee members' financial literacy and/or expertise, Implications throughout the enterprise of IFRS-based reporting and Educating the enterprise's stakeholder community.[8] The audit committee will have to determine different engagement plans and timelines for each client. The planning stage will be much longer for each client as the auditors must take extra time assessing what the new areas of concern will be under IFRS. Also, additional communication between the client's management and auditors will be key on the first-time transition, in order to make sure everyone involved understands and is educated about the processes that are taking place. According to a poll from KPMG, countries in Europe and Australia stated that they waited too long to get started and spent insufficient time in up front planning, needed to invest heavily in training finance staff, upgrading IT systems, and renegotiating contracts and although they saw IFRS as "quite similar" to GAAP, they found that small differences actually made a big difference.

[8] "The Transition to IFRS: Implications for the Audit Committee." Canada Audit Committee Update-KPMG LLP. December 10, 2010. www.kpmg.ca/ifrs.

Chapter #2
Use of Ratios By Investors and Creditors for their Respective Processes

Overview of the Bank Loan and Investment Processes

Financial statements are the key components necessary for creditors to make decisions about loaning to a company. Regardless of the company's status or size, a bank needs financial information about the company in order to be assured that the loan will be repaid and at a satisfactory rate. As for investors, their decision is a little more personal since it is their own equity they are looking to invest. There is a variety of information that is helpful in aiding these external users to reach a decision on the loan terms and investment choice. Depending on the industry of the business and the business' financial history and future, loan and investment decisions can be difficult.

Liquidity and profitability is the main concern for creditors when making loans. If a company does not have very good indications of being able to make profits, nor do they have reserves to pay back obligations as they come due, there is no reason for them to receive a loan. Financial statements are used to help investors and creditors gain insight into past operations, as well as project how things will happen in the future. The indicators, or ratios, that these external users apply, which will be further discussed in this chapter are: current ratio, debt to equity ratio, working capital, cash debt coverage, times interest earned, earnings per share, price- earnings ratio, return on stockholder's equity and payout ratio.

The income statement is required because creditors are concerned about whether income will be sufficient to repay the loan. It also helps them predict whether a firm has sufficient resources to handle a temporary financial crisis. As a whole, banks and investors are very concerned about trends over time. For this reason, they use trend analysis on financial statement for the past two or three years, as well as for the future year, to see if key components and ratios are significant, and will continue to be significant enough to uphold their liquidity status. The balance sheet is extremely important because it encompasses what happened on the income statement. It contains all the assets, liabilities and equity that are contained within the company. In order to see why these statements are so important, an analysis of the components that are contained in each of the above ratios, and what ideal ratios for the manufacturing, retail and service industries are, will be assessed. It is also important to remember that this analysis is being done under current accounting standards of U.S. companies, U.S. GAAP.

Ratios Used by Creditors and Investors Under U.S. GAAP

The first ratio for creditors and investors to consider and compute during quantitative analysis is the current ratio, which is calculated as current assets divided by current liabilities. The concept behind this ratio is to ascertain whether a company's short-term assets are readily available to pay off its short-term liabilities. In theory, the higher the current ratio, the better the company looks. However, not every industry is the same, and thus not every company is expected to have the same ratio. For the manufacturing industry, an ideal ratio is 1.5[9] and for the service industry, the ratio is 1.29[10]. The retail industry is composed of many different segments of businesses, which consist mainly of restaurants, apparel, automobiles, hardware, general merchandise and furniture. Therefore, depending on the company being assessed in the retail industry, the ratio can

[9] "Industry Norms- Key Business Ratios." Corporate Credit and Risk Management Solutions. March 1, 2011. http://www.creditguru.com/ratios/inr.htm.

[10] IBID

range from .73[11] of restaurants to 2.14[12] of general merchandisers. Since this ratio leaves room to potentially be misleading, depending on debt terms and operation cycles, this ratio cannot be fully trusted on its own, and wise creditors and investors will use this ratio along with the following ratios.

The next important ratio that creditors mainly rely on, but investors do look at as well, is the debt to equity ratio. This is calculated as total liabilities divided by total stockholders equity, and is a measurement of how much suppliers and creditors have committed to the company versus what the shareholders have committed. The lower the percentage means that a company is using less leverage and has a stronger equity position. As all ratios have their downside, the debt to equity ratio is not a pure measurement of a company's debt because it includes operational liabilities in total liabilities. Nevertheless, this easy-to-calculate ratio provides a general indication of a company's equity-liability relationship and is helpful to users looking for a quick take on a company's leverage. Generally, large, well-established companies can push the liability component of their balance sheet structure to higher percentages without getting into trouble. As seen with the current ratio, the service industry tends to have a lower debt to

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[11] "Industry Norms- Key Business Ratios." Corporate Credit and Risk Management Solutions. March 1, 2011. http://www.creditguru.com/ratios/inr.htm.

[12] IBID

equity ratio of .75[13], manufacturing is higher and between 1.3-1.4[14], and retail, has many sectors with a range of .91[15] in apparel to 2.61[16] in automobiles.

The next calculation is working capital, and is equal to current assets minus current liabilities. Positive working capital is required to ensure that a firm is able to continue its operations, and that it has sufficient funds to satisfy both maturing short-term debt and upcoming operational expenses. The management of working capital involves managing inventories, accounts receivable, accounts payable and cash. The larger the amount of working capital, the more funds a company has available to finance growth, expansion and other initiatives. For banks to ensure that businesses are properly and actively taking care of their working capital, they may ask to know the company's policies on depositing checks as soon as possible, billing over the entire month, not just at month-end, investing idle cash in interest-bearing accounts, taking vendor discounts for prompt payment, sending regular payment overdue reminders and look for disclosures on type of inventory method. The exact amount of working capital is not necessarily detrimental to banks, but positive working capital is an indication of a company's efficiency and financial strength, leading creditors and investors to believe it is a good investment.

Cash debt coverage is the next important ratio, and is found by dividing operating cash flow by total debt. This ratio provides an indication of a company's ability

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[13] "Industry Norms- Key Business Ratios." Corporate Credit and Risk Management Solutions. March 1, 2011. http://www.creditguru.com/ratios/inr.htm.

[14] IBID

[15] IBID

[16] IBID

to cover total debt with its yearly cash flow from operations. In theory, the higher the percentage ratio, the better the company's ability to carry its total debt looks. Since total debt is used for this computation, a ratio of less than one is not uncommon. A high double-digit percentage ratio is a sign of financial strength, while a low percentage ratio is a negative sign that indicates too much debt or weak cash flow generation. It is important for banks to investigate the larger factor behind a low ratio. To do this, they compare the company's current cash debt coverage ratio to its historic level in order to point out trends or warning signs.

Times interest earned ratio is another metric used to measure a company's ability to meet its debt obligations. It is calculated by taking a company's earnings before interest and taxes (EBIT) and dividing it by the total interest expense. It is usually presented as a ratio and indicates how many times a company can cover its interest charges on a pretax basis. This ratio is important for banks and investors to look at because companies failing to meet these obligations could force a company into bankruptcy. Ensuring interest payments to debt holders and preventing bankruptcy depends mainly on a company's ability to sustain earnings. However, a high ratio can indicate that a company has an undesirable lack of debt or is paying down too much debt with earnings that could be used for other projects. The rationale is that a company would yield greater returns by investing its earnings into other projects and borrowing at a lower cost of capital than what it is currently paying to meet its debt obligations. When a company's times interest earned ratio is only 1.5 or lower, its ability to meet interest expenses is questionable.

The next ratio, which is a profitability ratio, and is very important for investors, is earning per share (EPS). EPS is the portion of a company's profit allocated to each outstanding share of common stock. It is found by taking net income minus preferred stock dividends and dividing that by average shares of common stock outstanding. When investors perform analysis on a company, they look for a positive trend of EPS in order to make sure that the company is continuing to find ways to make more money. If they are not, then the company is not growing and in order to be appetizing to investors must at least be able to sustain income. Additionally, there are occasionally one-time events that will either benefit or hurt income, as a result, affecting EPS. In order to get a clear look at a company, investors must take these items into consideration and take their earnings out of the computation. EPS is not only important to investors as a way to assess profitability, but it is also needed to compute the price- earnings ratio and payout ratio.

The price- earnings ratio (P/E) is the best known of the investment valuation indicators. The P/E ratio is calculated by dividing the current stock price per share by the company's EPS, and shows how many times a stock is trading per each dollar of EPS. A higher P/E ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with a lower P/E. A high P/E also suggests that investors are expecting higher earnings growth in the future. In other words, P/E ratio shows current investor demand for a company share. The current S&P 500 P/E is 17.2[17], which is just above the historical amount of 15. It's usually more useful to compare the P/E ratios of one company to other companies in the same industry, to the market in

[17] "Is the S&P 500 Index Overvalued?" Investors Friend. March 2, 2011. http://www.investorsfriend.com/S%20and%20P%20500%20index%20valuation.htm.

general or against the company's own historical P/E. The average P/E for the manufacturing industry is 24.05[18], for the service industry is about 16.10[19] and for the retail industry the segments range from about 10[20] for apparel to 22[21] for furniture.

The return on stockholder's equity (ROE) is the next ratio to be calculated by investors, and is done so by dividing after tax net income by total stockholder's equity. This ratio indicates what amount of income is being generated by every dollar of equity. In other words, it tells the rate that shareholders are earning on their investment. Companies that generate high returns relative to their shareholder's equity are companies that pay their shareholders well, creating substantial assets for each dollar invested. These businesses are more than likely self-funding companies that require no additional debt or equity investments. Since ROE shows how well a company uses investment funds to generate earnings growth, rates between 10% and 15% are considered desirable.

The last ratio, the payout ratio, is the amount of earnings actually paid out in dividends to shareholders. It is computed by dividing dividends per share by EPS. Investors can use the payout ratio to determine what companies are doing with their earnings. A lower payout ratio indicates that a company is more concerned with retaining its earnings, rather than paying out dividends to its owners. For companies that are growing fast, they will maintain more cash to use for expansion projects thus have less

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[18] "Manufacturing Company List." Yahoo! Finance. March 1, 2011. http://biz.yahoo.com/p/_basicm-chmmfg.html.

[19] "Personal Service Industry Rankings." Y Charts. March 2, 2011. http://ycharts.com/calculations/rankings/industries/Personal%20Services/pe_ratio.

[20] "Apparel Industry." Apparel Company Financial Information. March 2, 2011. http://www.advfn.com/p.php?pid=financials&symbol=AMEX%3ADLA.

[21] "Furniture Company Ratios." Yahoo! Finance. March 2, 2011. http://finance.yahoo.com/q?s=HVT.

money to pay out as dividends. Additionally, companies usually have a low payout ratio because they would rather fund their growth internally through retained earnings than through external funding such as stock.

Chapter #3
The Controversial Change to International Financial Reporting Standards and Overview of Selected Standards

Concerns About IFRS

According to the IASB, "how an entity presents information in its financial statements is vitally important because financial statements are a central feature of financial reporting — a principal means of communicating financial information to those outside an entity."[22] There are three objectives associated with the changes that the IASB have proposed. These objectives are that information should be presented in the financial statements in a way that: (a) Helps users assess an entity's liquidity and financial flexibility. (b) Portrays a consistent, complimentary financial picture of an entity's activities and items. (c) Disaggregates information so that it is useful in predicting the entity's future cash flows.

For a variety of technical, legal and practical reasons, CPAs across the U.S. believe IFRS will not enhance comparability of financial statements across companies. As this is one of the purported benefits of IFRS, if not the primary benefit being hyped, a positive net benefit from convergence is somewhat illusory. Moreover, another benefit of IFRS put forth in the proposed SEC Roadmap is the added flexibility afforded to issuers to account for transactions and events by applying their own judgment. For this reason, CPAs are concerned that opportunities for management judgment will actually result in less comparability. For purposes of examining potential comparability and management's judgment issues, an analysis of the SEC's top nine IFRS issues will be discussed in this chapter. These nine issues have been selected from a speech made at the 2010 AICPA National Conference on Current SEC and PCAOB Developments and consist of:

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[22] Benzacar, Karine. "IFRS brings a radical change to financial statement presentation." *CMA Management*. February 2009. Pages 28-33.

"*Impairment of Assets:* IAS 36, *Financial Statement Presentation:* IAS 1 & 7, *Operating Segments:* IFRS 8, *Revenue:* IAS 18, *Income Taxes:* IAS 12, *Property, Plant and Equipment:* IAS 16, *Employee Benefits:* IAS 19, *Provisions, Contingent Liabilities and Contingent Assets:* IAS 37 and *Consolidated Financial Statements:* IAS 27."[23]

Hot Topics In IFRS

Impairment of Assets- IAS 36

The objective of this standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount.[24] An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through its use or sale. If there is any indication that an asset is impaired, the recoverable amount is estimated by management for the individual asset. If it is not possible to estimate this recoverable amount, an entity determines the recoverable amount of the cash-generating unit to which the asset belongs. Since management is able to determine this recoverable amount on their own, some investors are skeptical as to the validity of management's judgment. The recoverable amount of an asset, or a cash-generating unit, is the higher of its fair value less costs to sell and its value in use. If either of these amounts, fair value less costs to sell or value in use, exceeds the asset's carrying amount, the asset is not impaired. However, if the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. That reduction is the impairment loss. This loss is recognized immediately in net income, unless the asset is carried at the revalued amount in

[23] "AICPA National Conference on Current SEC and PCAOB Developments 2010". AICPA. March 7, 2011. http://www.aicpaconferencematerials.com/sec/?select=session&sessionID=59.

[24] "IAS 36." IASB. March 7, 2011. www.iasb.org/nr/rdonlyres/a288c781-7d39-4988-ba71.../0/ias36.pdf.

accordance with another standard such as with the revaluation model in IAS 16 *Property, Plant and Equipment.*[25] In that case, the revalued asset is treated as a revaluation decrease in accordance with that other standard.

Financial Statement Presentation- IAS 1 and 7

There will no longer be an Income Statement, Balance Sheet, Statement of Retained Earning and Statement of Cash Flows. Instead, entities prepare the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity and the Statement of Cash Flows. There is an additional statement reconciling net income to cash flow, which is included in the financial statement notes. Each of the statements includes all of the same general categories. These consist of: a business section, subdivided further into operating and investing elements, a financing section, income taxes, discontinued operations, and equity. To gain a better understanding of which category is included in each statement see Exhibit 1 on the following page.

The most recognizable difference in the new balance sheet is that assets do not equal liabilities plus equity. Instead, assets and liabilities are netted together in each of the sections of the Statement of Financial Position. Additionally, since IFRS is more of a principles based system rather than rules based, management has been given the responsibility to segregate assets or liabilities into each of the different sections according to their judgment, but their basis for classification must be disclosed in the financial statement notes. Amongst other changes include: totals for short-term and long-term assets being optionally placed in either the statement of financial position or the notes to financial statements, and there is no total for liabilities plus equity.

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[25] "IAS 36." IASB. March 7, 2011. www.iasb.org/nr/rdonlyres/a288c781-7d39-4988-ba71.../0/ias36.pdf.

The income section of the income statement is further divided into an operating section, an investing section, a financing section, income taxes, and discontinued operations. Furthermore, line items cannot be generally listed. For example, cost of goods sold must be further subdivided into materials costs, labor costs, and overhead, and details for general and administrative expenses must also be disclosed.

When creating the Statement of Cash Flows, entities must use the direct method, and instead of reconciling income at the end of this statement, cash flows are reconciled to comprehensive income in the footnotes.

The Statement of Changes in Equity shows the balance of each component of equity at the beginning and end of the period, and identifies the changes resulting from income, other comprehensive income, retrospective restatements and transactions with owners.

Exhibit 1: IFRS Statement Overview

Statement of Comprehensive Income	Statement of Financial Position	Statement of Cash Flows
Business • Operating Income • Investing Income	Business • Operating Assets and Liabilities • Investing Assets and Liabilities	Business • Operating Cash Flows • Investing Cash Flows
Financing • Financing Income • Financing Expenses	Financing • Financing Assets • Financing Liabilities	Financing • Financing Asset Cash Flows • Financing Liabilities Cash Flows
Income taxes on continuing operations	Income taxes	Income taxes
Discontinued Operations (net of tax)	Discontinued Operations	Discontinued Operations
Other Comprehensive Income (net of tax)		
	Equity	Equity

Operating Segments- IFRS 8

IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the entity that are regularly reviewed by management, in order to allocate resources to the segment and to assess its performance. IAS 14, which IFRS 8 replaced as of 2009, required an entity to identify two sets of segments, business and geographical, with the entity's, "system of internal financial reporting to key management personnel,"[26] serving only as the starting point for the identification of such segments. If under IAS 14 an entity identified its primary segments on the basis of the reports provided to management, those can become the 'operating segments' for the purposes of IFRS 8.

IFRS 8 does not define segment revenue, segment expense, segment income, segment assets or segment liabilities, but does require a disclosure of how segment income, segment assets and segment liabilities are measured for each operating segment. These disclosures include information about how the entity identifies its operating segments and the types of products and services from which each segment derives its revenues. As a consequence, entities have more discretion in determining what is included in segment income under IFRS 8, limited only by their internal reporting practices. For this reason, users lose the ability to compare companies because each entity's internal reporting may differ from the others.

Revenue- IAS 18

This standard identifies the circumstances in which revenue criteria are met and recognized. In certain circumstances, it is necessary to apply recognition criteria to

[26] "IFRS 8 Operating Segments." IAS Plus. Deloitte. March 8, 2011. www.iasplus.com/standard/ifrs08.htm.

separately identifiable components of a single transaction in order to reflect the substance of the transaction. Conversely, the recognition criteria are applied to two or more transactions together when the transactions are linked in a way so that the commercial effect cannot be understood without reference to the series of transactions as a whole.[27] Additionally, revenue is measured at fair value of the receivable or consideration received. The following are the conditions under which revenue is recognized: ownership and physical and managerial control is transferred, revenue can be measured reliably, collection is probable and cost of transaction can be measured reliably as well. When the outcome of the transaction cannot be estimated reliably, revenue is recognized only to the extent of the expenses recognized that are recoverable.

This statement also provides insight about interest, dividends and royalties. Use of entity assets by others yielding interest requires the interest revenue to be recognized over time, computed on the effective yield on the asset. Dividends are recognized when the shareholder has the right to receive payment. Royalties are recognized in accordance with the substance of the agreement. Management must disclose revenue recognition policies, such as what their definition of probable and reliable is, as well as the amount of revenue recognized from exchanges of goods or services. Although this standard may seem like it is fairly strict and covers all of its reporting bases, revenue recognition is the number one case for fraud. Therefore, the simplicity may be misleading since it has the tendency to be manipulated so often.

Income Tax- IAS 12

The principal issue in accounting for income taxes is how to report the current and

[27] "IAS 18 Revenue." IASC Foundation Education. March 8, 2011. www.iasb.org/NR/rdonlyres/1A3771B8-5627-44E4-984E.../ias18sum.pdf

future tax consequences of "the future recovery of the carrying amount of assets or liabilities that are recognized in an entity's statement of financial position, and for events of the current period that are recognized in an entity's financial statements."[28] Taxes for current and prior periods are classified as a liability. However, if the amount paid exceeds the amount due, then an asset is recorded. Tax liabilities and assets are measured according to the amount expecting to be paid to tax authorities or recovered in the future. A deferred tax asset is recognized for the carryforward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available. The flexibility of this standard is that the carrying amount of a deferred tax asset is reviewed at the end of each reporting period by management. Management then assesses the company's ability to generate future profits, and decides whether the company will be able to take advantage of the deferred tax assets in the future. If not, then the entity reduces the carrying amount of the deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of the deferred tax asset. Once again, that is based on management's judgment, and there is no strict criteria establishing what grounds create a belief of probable future profits of a company.

Property, Plant and Equipment- IAS 16

The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognized in relation to them.[29] An item of property, plant and equipment that qualifies for recognition as an asset is measured at

[28] "IAS 12 Income Taxes." IASC Foundation. March 8, 2011. www.iasb.org/NR/rdonlyres/8EB2D1D7-47D7-45F9.../0/ias12sum.pdf

[29] IAS 16 Property, Plant and Equipment. IASC Foundation. March 8, 2011. www.iasb.org/NR/rdonlyres/C10C2381-6B52-4C4A.../0/ias16sum.pdf

cost. Cost includes: purchase price and any expenses incurred during the process of preparing the equipment for operation or moving the asset to a specific location for operation. After recognition, the asset is carried at its cost less any accumulated depreciation or impairment losses. Alternatively, the entity can chose to revaluate the asset after recognition, in which case the asset is carried at fair value as of the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. If this revaluation method is chosen, revaluations are to be made "with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date."[30] This is one of the most controversial areas because of the struggle between relevance, reliability, transparency and comparability. Since companies are able to choose which method to implement, comparability is lessened. As a result of the revaluation option, earnings can be affected by the gains and losses making earnings less reliable and less transparent. However, the fight for this is that being able to change to fair value gives the company the ability to make their assets reflect the true current, underlying value, thus making the method more relevant.

Employee Benefits- IAS 19

This standard requires an entity to recognize a liability when an employee has provided service in exchange for employee benefits to be paid in the future, and an expense when the entity consumes the economic benefit arising from service provided by

[30] IAS 16 Property, Plant and Equipment. IASC Foundation. March 8, 2011. www.iasb.org/NR/rdonlyres/C10C2381-6B52-4C4A.../0/ias16sum.pdf

an employee.[31] There are two types of plans that are used to take care of post-employment benefits: defined contribution plan or defined benefit plan.

Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity, and has no further legal duty as far as the employee receiving those assets. The entity's legal obligation is limited to the amount that it agrees to contribute to the fund. This amount can be a result of how much the employee and employer have contributed together, along with the investment income arising from these contributions. Therefore, investment risk and actuarial risk fall on the employee.

Defined benefit plans differ from defined contribution plans because in defined benefit, the investment risk and actuarial risk fall on the entity rather than the employee. Additionally, defined benefit involves a lot more steps that lead to an estimated number because some parts of the formula are not 100% determinable. The accounting involves using actuarial techniques to make an estimate of the amount of benefit that employees have earned in return for their service in the current and prior periods. This requires an entity to determine how much benefit is attributable to the current and prior periods and to make estimates about variables, such as employee turnover, mortality, future increases in salaries and future medical costs that will influence the cost of the benefit. Depending on what type of plans are offered for entities, and what the terms of those plans are, each company could have very different contribution liabilities and expenses, even if they in fact had the same number of employees.

[31] "IAS 19 Employee Benefit Plans." IASC Foundation. March 9, 2011. www.iasplus.com/standard/ias19.htm

Provisions, Contingent Assets and Contingent Liabilities- IAS 37

The objective of this standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets.[32]

A provision is recognized when an entity has a present obligation as a result of a past event, it is probable that an outflow of assets will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Once again, IFRS is criticized for using such loose terms as probable rather than quantitative numbers to measure criteria by. It is because of management's interpretations of these words that make financial statements too inconsistent.

A contingent liability is a possible obligation that arises from past events and whose existence is confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. Furthermore they can also result from a present obligation that arises from past events but is not recognized because it is not probable that an outflow of assets will be required to settle the obligation, or the amount of the obligation cannot be measured with sufficient reliability. In this case it is stated that an entity should not recognize a contingent liability, but rather disclose such, unless the possibility is remote. The frustration of this statement cannot be stressed enough. Management can interpret this as much or as little as they like, however it is so loosely written, that it is as if it is barely a principle at all.

The same criteria stand for contingent assets as well, however, an entity is to recognize the asset when the realization of income is virtually certain. This is once again

[32] IAS 37 Provisions, Contingent Liabilities and Contingent Assets." IASC Foundation. March 9, 2011. www.iasb.org/NR/rdonlyres/81F90956-3009-4346-B727.../ias37sum.pdf

another example of management being able to interpret words however they want. Using words such as, "virtually" leave open the possibility that one company will take that to mean they will recognize the asset or liability when they are 60% sure, on the other hand, another company could consider, "virtually" to mean when they are 99% sure. This wide array of interpretations provides less transparency and comparability for investors and creditors, which is the opposite of what IFRS claims to achieve.

Consolidated Financial Statements- IAS 27

This standard is applied in the preparation and presentation of consolidated financial statements for a group of entities under the control of a parent.[33] In preparing consolidated financial statements, an entity combines the financial statements of the parent and its subsidiaries line by line by adding together like items of assets, liabilities, equity, income and expenses. In order for the consolidated financial statements to present financial information about the group, as if they were that of a single economic entity, the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated. Additionally, minority interests are presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity. Any intergroup balances, transactions, income and expenses are eliminated in full.

This standard is also applied in accounting for investments in subsidiaries, jointly controlled entities and associates when an entity elects, or is required by local regulations, to present separate financial statements.[34] When these separate financial statements are prepared, investments that are not classified as held for sale are accounted

[33] "IAS 27 Consolidated Financial Statement." IASC Foundation. March 9, 2011. www.iasb.org/NR/rdonlyres/51A969A8-CC91-4C2C.../0/ias27sum.pdf

[34] IBID

for at cost, or in accordance with IAS 39, which states the investments are measured at fair value. IAS 27 also brings up the big decision that is given to management as in *Property, Plant and Equipment*-IAS 16. It seems that if IFRS is deemed to provide for consistency and comparability, management should not be given so much freedom to make so many choices about how to value certain assets. Ultimately, the principles of IFRS seem to give entities too much room for interpretation, and too little rules of how to uniformly prepare financial statements for all companies.

Chapter #4
Theoretical and Analytical Reconciliation of Differences Between IFRS and U.S. GAAP

Disclaimer And Chapter Overview

For years prior to 2007, the SEC required a reconciliation of IFRS financial statements to U.S. GAAP by foreign registrants. The SEC eliminated this provision in 2007. Due to this event, information regarding the differences between U.S. GAAP and IFRS is no longer readily available. For analytical purposes, available data for 2005 and 2006 will be used.

In order to study the affects that international standards can have on companies in comparison to U.S. GAAP, there will be an analytical report of SAP Group within this chapter. This report will be an examination of SAP Group's ratios (the nine discussed previously in this paper) under U.S. GAAP and IFRS, how the standards affect the result of these ratios and what those results mean to investors and creditors.

Since SAP is only one company, and in one industry, there are a variety of issues that may not be evident in their financial statements. In order to also bring light to these areas as well, a limited analysis of major areas of concern, from selected financial data, will be prepared for Nokia, GlaxoSmithKline and Alcatel Lucent. This analysis will also serve to support the findings from SAP and provide more evidence for conclusions.

Background for Analysis

In recent years, the Securities and Exchange Commission (SEC) has made the convergence of U.S. GAAP with IFRS a priority. In this regard, the SEC issued a Concept Release to explore the possibility of eliminating reconciliations to U.S. GAAP. As mentioned above, that requirement was repealed in 2007. The reason for this elimination came about during a study from previous years. In February 2000, the SEC staff undertook studies examining 1998 reconciliations presented in the 20 F forms of foreign filers to understand the extent of differences between U.S. GAAP, IFRS, and other foreign accounting standards. Subsequently, in 2002 the SEC staff conducted a second study, focusing on IAS/IFRS users.

The analysis during the second study looked at 20 F forms of 100% of the IFRS registrants filing with SEC in 2001 to identify the nature, type and magnitude of differences that exist between IFRS and U.S. GAAP. Each type of difference in the 20 F registrations was examined by tracing it to its exact source. The reconciliation entries were organized according to the relevant IAS standards generating these differences. This process of understanding and dissecting the differences has led to the identification of differences that would not have been revealed otherwise. These filings identified reconciliations of IFRS amounts to U.S. GAAP amounts. The filers' financial statements and the footnotes to forms 20 F were also analyzed to determine the source of the differences between U.S. and IFRS. A similar analysis will be provided for the purpose of this paper; however, the focus of information will be regarding the impact on investors and creditors.

About The Companies Used for Analysis

SAP Group (NYSE: SAP), headquartered in Walldorf, Germany, is the market leader in enterprise application software. SAP stands for "Systems, Application and Software."[35] Today, SAP has sales and development locations in more than 50 countries worldwide, and their services enable more than 109,000 customers worldwide to operate

[35] "About SAP." SAP Americas. March 10, 2011. http://www.sap.com/usa/about/index.epx

profitably, adapt continuously, and grow sustainably. SAP empowers people and organizations to work together more efficiently and use business insight more effectively to stay ahead of the competition. They do this by extending the availability of software across on-premise installations, on-demand deployments and mobile devices. Although their IPO came in 1988, they recently converged to IFRS in 2006. They have since then, held an "Implementing IFRS Q&A" session for their investors and all others interested in their process and decision- making during convergence. References to these questions and SAP Group's answers will be made throughout this chapter, in accordance with issues in areas of question.

Nokia Corporation (NYSE: NOK), headquartered in Espoo, Finland, manufactures and sells mobile devices, and provides Internet and digital mapping and navigation services worldwide. It also offers Internet services focusing on music, navigation, media, and messaging. It is Nokia Siemens Networks segment that provides mobile and fixed network solutions and related services to operators and service providers. This segment offers "various business solutions, such as consulting and systems integration; network and service management, charging and billing software and subscriber database management."[36] In accordance with IFRS, Nokia released information in 2006, reconciling their financial statements from U.S. GAAP to IFRS for the years ending December 31, 2004, 2005 and 2006. For the purpose of this paper, the year ending December 31, 2006 will be used.

[36] "About Nokia." Nokia. March 11, 2011. http://www.nokia.com/about-nokia/company

GlaxoSmithKline (NYSE: GSK), headquartered in the UK, has the mission of "improving the quality of human life by enabling people to do more, feel better and live longer."[37] This mission gives GSK the purpose to develop innovative medicines and products that help millions of people around the world. They are one of the world's leading research-based pharmaceutical and healthcare companies, and are a global organization with offices in over 100 countries and major research centers in the UK, U.S., Belgium and China. GSK also helps developing countries where debilitating disease affects millions of people and where access to life-changing medicines and vaccines is a problem. To meet this challenge, GSK is committed to providing discounted medicines where they are needed the most. Additionally, they are one of the few pharmaceutical companies researching both medicines and vaccines for HIV/AIDS, tuberculosis and malaria. GlaxoSmithKline also produces medicines that treat major disease areas such as asthma, anti-virals, infections, mental health, diabetes, and cardiovascular and digestive conditions. In accordance with IFRS, GlaxoSmithKline released information in 2006, reconciling their financial statements from U.S. GAAP to IFRS. For the purpose of this paper, the year ending December 31, 2005 will be used.

Alcatel Lucent (NYSE: ALU), headquartered in Paris, France, offers products, solutions, and transformation services that "enable service providers, enterprises, governments, and strategic industries to deliver voice, data, and video communication services to end-users worldwide."[38] It engages in the development and sale of software and related services to manage customer interactions. The company offers a software

[37] "About Us." GSK. March 11, 2011. http://www.gsk.com/about/

[38] "Company Overview." Alcatel Lucent. March 11, 2011. http://www.alcatel-lucent.com/aboutus/companyoverview.html

suite that connects customers with the resources to fulfill customer requests and meet customer care goals. It also provides software and related services, which support service provider business priorities in the areas of "application innovation, enhanced communications, digital media, real-time rating and charging, and subscriber data management,"[39] as well as offers tools for providers to enable consumers to set up and manage their mobile devices and services at-home. In accordance with IFRS, Alcatel Lucent released information reconciling their financial statements from U.S. GAAP to IFRS. For the purpose of this paper, the year ending December 31, 2006 will be used.

Analysis of SAP

Through a theoretical approach, the effect of the convergence between U.S. GAAP and IFRS on selected income statement, balance sheet and equity accounts was examined. In order to understand the impact that the differences will have on individual companies, it is beneficial to recognize what comprises the adjustments that companies have reported when reconciling IFRS back to U.S. GAAP. Tracing the nature and type of reported differences to its exact source is a very challenging task, especially from an external users' perspective. For this purpose, Figure 1 in the Appendix is intended to show types and nature of the differences that occur most frequently in 20 F reconciliations. As for the SAP Group, their income reconciliation can be found as Figure 2, assets as Figure 3, liabilities in Figure 4 and equity in Figure 5 as follows.

Figure 2 shows how SAP Group's net income is adjusted from IFRS to U.S. GAAP. Although comparing the income from IFRS with that of U.S. GAAP may lead one to conclude that there are not many changes between the two accounting methods,

[39] "Company Overview." Alcatel Lucent. March 11, 2011. http://www.alcatel-lucent.com/aboutus/companyoverview.html

there are indeed many adjustments that took place in the reconciliation. Due to a lower operating profit under IFRS, which resulted in a lower tax expense, the income needed to be adjusted for an additional €24 million for 2006. The impact on Net Income from the reversal of the depreciation under U.S. GAAP is €1 million resulting from a 2006 business combination. Under IFRS, SAP accrued €11 million in the transition period for estimated losses resulting from consulting or development projects which were not recorded under U.S. GAAP at the end of 2006. For cash-settled and equity-settled share-based payment arrangements, SAP did not use the exemption of IFRS 1, but adopted IFRS 2 Share-based payment. The difference between the intrinsic value method and the fair value method was recorded and decreased income by €36 million. The last topics are pensions and termination benefits. Recognition of €2 million of unrecognized pension cost from actuarial gains and losses, prior service cost, and other components was done in order to present the full obligation in accordance with SFAS 158. Employers' offers to encourage voluntary retirement, qualify as termination benefits under IFRS, and obligations for probable bonus feature payments to candidates are recorded based on management's best estimate of the number of employees expected to enter into early retirement agreements. However, under U.S. GAAP, only benefits for the inactive period of contractually bound participants are ratably recognized over the period from signing the early retirement agreement to the end of employment, as they are considered post-employment benefits. As a result, income decreased by €11 million due to recognizing the corresponding liability. Although U.S. GAAP results in a 2% increase of income for SAP, that is not always the case. It is important to look at how many items went into this reconciliation, rather than just the net effect. A different company could record the same adjustments, but result in a much larger effect, as will be seen later.

Figure 2:

SAP GROUP INC.
RECONCILIATION OF NET INCOME
(in EURm)
JANUARY 1, 2006

Profit attributable to equity holders reported under IFRS	1836
U.S. GAAP adjustments:	
Depreciation	1
Customer Related Obligations	(11)
Restructuring Plans	(2)
Pensions	(2)
Termination Benefits	(11)
Share-based compensation expense	(36)
Currenct Impact on Disposal of Entities	2
Other differences	(1)
Deferred tax effect of US GAAP adjustments	24
Net Income under U.S. GAAP	1871
Percent Change	1.91%

In Figure 3, it first appears that IFRS may decrease the appearance of assets. Some changes have no affect on total assets such as classification differences, but some of the other adjustments do. Furthermore, some of these adjustments are from current asset accounts to noncurrent asset accounts, which do not affect SAP's position as a whole, but may affect some ratios. One classification example is classifying other financial assets and liabilities as well as income tax receivables under "other assets" and "other liabilities" for U.S. GAAP, but showing them as a separate line item on the face of the balance sheet in accordance with IAS 1. Another example is that IFRS requires that all deferred tax items, including those that relate to current assets and liabilities, be presented as noncurrent items, whereas under U.S. GAAP the classification of deferred tax follows the classification of the underlying item. As for changes that do have an impact on total assets, goodwill is a good example. Under IFRS, contingent purchase price components have to be recorded when payment is probable and the amount can be reliably estimated. Under U.S. GAAP these purchase price components are capitalized on payment, when the contingency is resolved. As a result, the goodwill initially recognized under IFRS is higher than under U.S. GAAP by €14 million.

Figure 3:

SAP GROUP INC.
RECONCILIATION OF ASSETS
(in EURm)
JANUARY 1, 2006

	Under IFRS	Reclassif-ication	Valuation Adjustment	Under U.S. GAAP	Percent Change
Other Financial Assets		80			
Financial assets		80			
Other assets		(157)			
Income tax receivables		77			
Deferred tax assets		(129)			
Prepaid expenses/deferred charges			1		
Current assets	6392	(129)	1	6520	2.00%
Goodwill			14		
Intangible Assets			(1)		
Other Financial Assets		437	(166)		
Financial assets		437	(166)		
Other assets		(441)			
Income tax receivables		4			
Deferred tax assets		129	2		
Prepaid expenses/deferred charges			10		
Noncurrent assets	2508	129	(141)	2520	0.48%
Total assets	8900		(140)	9040	1.57%

Contradictory to the decrease in assets that IFRS showed, liabilities in Figure 4 are reported less than under U.S. GAAP. A large discrepancy, that SAP is a perfect candidate for discussing since it shows theory applied in practice, is about the recognition of liabilities. Both, under U.S. GAAP and IFRS, a liability has to be recorded if it is probable that there will be future economic outflows based on past events, and the amount of the obligation can be measured reliably. However, the interpretation of "probable" is not the same under IFRS and U.S. GAAP. While under IFRS probable means more likely than not, under U.S. GAAP probable indicates a higher probability than it does under IFRS. Therefore, SAP states in their footnotes that they recognized certain provisions under IFRS that they did not record under U.S. GAAP. Additionally, as mentioned in regards to assets, there are similar classification differences with liabilities as well, that do not have huge impacts on total liabilities, but do affect current and long-term liability totals individually.

Figure 4:

SAP GROUP INC.
RECONCILIATION OF LIABILITIES
(in EURm)
JANUARY 1, 2006

	Under IFRS	Reclassif-ication	Valuation Adjustment	Under U.S. GAAP	Percent Change
Financial liabilities		80			
Other liabilities		(80)	14		
Provisions			1		
Deferred income taxes		(44)			
Current liabilities	2714	(44)	15	2743	1.07%
Financial liabilities		11			
Other liabilities		(11)			
Provisions			(118)		
Deferred income taxes		44	(11)		
Noncurrent liabilities	422	44	(129)	507	20.14%
Total liabilities	3136		(114)	3250	3.64%

By looking at Figure 5, it looks like IFRS and U.S. GAAP differences are minimal and have virtually no impact on equity. However, the big differences lie with the main components of equity, which are retained earning and accumulated other comprehensive income. Within these two subsets of accounts, many different reconciliations had to be made. AOCI decreased from a loss of (311) under U.S. GAAP to a loss of only (112) under IFRS, while retained earnings decreased from 6589 under U.S. GAAP to 6368 under IFRS. The main causes of this respective increase and decrease was due to reclassifications under IFRS. The increase in AOCI under U.S. GAAP compared to the amount under IFRS is the result of setting foreign currency losses to zero with a corresponding offset in retained earnings, a revaluation of previously unrecognized cash flow hedges and unrecognized actuarial pension gains and losses. Additionally, Under IFRS, minority interests are included in Shareholders' equity.

Figure 5:

SAP GROUP INC.
RECONCILIATION OF EQUITY
(in EURm)
JANUARY 1, 2006

Capital attributable to equity holders under IFRS	6123
U.S. GAAP adjustments:	
Cumulative foreign currency translation adjustment	(1)
Gains/losses on STAR hedges (net of tax)	(8)
Pension cost	(45)
Deferred taxes	28
Depreciation	1
Customer-related obligations	(11)
Share-based compensation programs	6
Restructuring obligations	(2)
Other reconciliations	8
Disposal of entities	2
Presentation of Minority interests	9
Total Stockholder's Equity under U.S. GAAP	6136
Percent Change	0.21%

Figure 6 compiles the last four, previously discussed figures regarding SAP's income, assets, liabilities and equity under both IFRS and U.S. GAAP, and demonstrates the creation of the nine ratios used by investors and creditors. Not only does it show the nine ratios, but it also shows the percent change from U.S. GAAP to IFRS for each input required. As a result of classification differences for current assets and liabilities, the current ratio is lower under IFRS. Although the effect seems minimal, the fact is that it is different, and the adjustments could influence the reliability of a typical ratio. Additionally, the lack of liability recognition under IFRS allows SAP to manipulate their debt to equity ratio lower under IFRS. This means if SAP was required to keep a certain debt to equity ratio, for purposes of following their debt covenants, management would have the ability to record as much or as little debt as needed. The lower reported net income under IFRS deceases the times interest earned ratio, and it also decreases earnings per share. Times interest earned is decreased by 12 times under IFRS, and a .11 decrease in EPS could potentially influence an investor's decision. Since EPS is lower under IFRS, the price-earnings ratio acts inversely and results in a higher P/E ratio under IFRS. SAP doesn't pay dividends, so the payout ratio is unnecessary, and the return on stockholder's equity is not affected too much by the changes in income and equity since they were virtually offsetting. However, with such decreases taking place in retained earnings, stockholder's equity has the potential to be very low.

Figure 6:

SAP Group	Financial Information at January 1, 2006				
	(in € millions)	U.S. GAAP	IFRS		
Required Information		2006	2006	DIFF	% Change
	Current Assets	6520	6392	(128)	(1.96%)
	Current Liabilities	2743	2714	(29)	(1.06%)
	Total Liabilities	3250	3136	(114)	(3.51%)
	Total Equity	6123	6136	13	0.21%
	Cash Provided by Operations	1821	1847	26	1.43%
	Average Total Liabilities*	3250	3136	(114)	(3.51%)
	Net Income	1871	1836	(35)	(1.87%)
	Interest Expense	4	4	0	0.00%
	Tax Expense	792	778	(14)	(1.77%)
	Preferred Stock Dividends	0	0	0	0.00%
	Average Common Shares Outstanding~	316	316	0	0.00%
	Stock Price Per Share	48.84	48.84	0	0.00%
	Cash Dividends Declared on Common Stock	0	0	0	0.00%
	Average Common Stockholder's Equity^	5782	5764	(18)	(0.31%)
Computations for Creditors					
	Current Ratio	2.38	2.36	0.02	
	Debt to Equity	0.53	0.51	0.02	
	Working Capital	3777.00	3678.00	99.00	
	Cash Debt Coverage	0.56	0.59	(0.03)	
	Times Interest Earned	666.75	654.50	12.25	
Computations for Investors					
	Earnings Per Share	5.92	5.81	0.11	
	Price-Earnings Ratio	8.25	8.41	(0.16)	
	Payout Ratio	0	0	0	
	Return on Common Stockholder's Equity	0.32	0.32	0.01	

Key

*Average Total Liabilities is reflected as Total Liabilities due to the lack of information available and timing of convergence to IFRS

~ Average Common Shares Outstanding was computed by adding 2004 Outstanding Common Shares (316,004) + 2005 Outstanding Common Shares (316458) and dividing by

^ Average Common Stockholder's Equity is reflected as Shareholder's Equity for January 1, 2006, rather than an average of 2004 and 2005 due to the lack of information available and timing of convergence to IFRS

Analysis of Reconciling Adjustments for NOK, GSK and ALU

When reconciling back to U.S. GAAP from IFRS, there are various adjustments that both increase and decrease net income, assets, liabilities and equity across companies, as seen in SAP. In order to understand a broader, overall significance of these items, a comparison among net effect of income reconciliation is displayed for Nokia, GlaxoSmithKline and Alcatel Lucent, and further segregated by items that increase and decrease net income from IFRS to U.S. GAAP. Additionally, a comparison is displayed regarding the reconciling adjustments that increase and decrease equity across these companies. It is important to note however, that these reconciling items affect companies reporting under IFRS and converting back to U.S. GAAP. When reporting under U.S. GAAP and converting to IFRS, there may be new reconciling items as well as reconciling items that no longer exist.

Through the following figure 7, graphical representation of reconciling adjustments for net income can be seen segregated by item for each company. It provides evidence on whether the differences in accounting standards result in under- or overstatements of IFRS income relative to U.S. income. In the companies used for this analysis, all three yield lower incomes with U.S. GAAP than with IFRS. Some major areas of concern based on these three companies are pensions, amortization and impairment of intangible assets and the effect on deferred taxes. As a result of these drastic changes, return to stockholders equity will be lower, earnings per share will decrease which will in turn cause the price- earnings ratio to appear inflated. ALU is affected the most by the reconciliation because their financial position goes from looking bad to worse. Their income decrease of 236.21% allows their EPS to drop from (.16) to

(.54). However, NOK's fractional decrease of .72% only slightly changes EPS from 1.06 under IFRS to 1.05 under U.S. GAAP. As for GSK, the reconciliation has a small to moderate affect on their earnings. However, their 27.85% decrease in income under U.S. GAAP dramatically drops their EPS from 84.8 to 58.8. This is surely enough of an effect to make an investor change their mind, and a creditor to think twice about a loan or have a higher interest rate.

Figure 7:

NOKIA, GLAXOSMITHKLINE AND ALCATEL LUCENT
RECONCILIATION OF NET INCOME
(in EURm for NOK, £m for GSK and $m for ALU)
DECEMBER 31, 2006 for NOK and ALU
DECEMBER 31, 2005 for GSK

	Nokia	GlaxoSmithKline	Alcatel Lucent
Profit attributable to equity holders reported under IFRS	4306	4689	(232)
U.S. GAAP adjustments:			
Amortization and impairment of intangible assets		(1584)	
Amortization and impairment of goodwill			(532)
Restructuring Plans			(61)
Sale and lease-back transactions			(66)
Acquisition and disposal of product rights		(72)	
Write-off of in-process R&D acquired		(26)	
Pensions	(1)	(127)	80
Development costs	(55)		52
Share-based compensation expense	(8)	6	(5)
Derivative instruments and hedging		(30)	52
Tax benefits on exercise of stock options		(47)	(44)
Other differences	22	(58)	(22)
Deferred tax effect of US GAAP adjustments	11	585	
Net Income under U.S. GAAP	4275	3336	(780)
Percent Change	-0.72%	-28.85%	-236.21%

Through figure 8 on the following page, graphical representation of reconciling adjustments for total equity can be seen segregated by item for each company. It provides evidence on whether the differences in accounting standards result in under- or overstatements of IFRS equity relative to U.S. equity. In the companies used for this analysis, all three yield higher amounts of equity with U.S. GAAP than with IFRS. As compared to the percent change of income, it seems that GSK and ALU switch positions for equity reconciliation. GKS reports 368.91% more equity under U.S. GAAP than IFRS. This increase in equity, coupled with the decrease in income, dramatically decreases their return on equity from a whopping 64% under IFRS, to a measly 10% under U.S. GAAP. ALU's reconciliation of equity mirrors the idea stated above about their income reconciliation; that the change from IFRS to U.S. GAAP makes their company's appearance worse under U.S. GAAP. Their 24.47% increase in equity, coupled with their huge decrease in income lowers their return on equity from an already worrisome (1%), even lower to (3%). Nokia, once again, was very minimally affected by the reconciliation. With a 1.05% increase in equity and a .72% decrease in income, their return on equity decreases from 36% to 35%.

Figure 8:

NOKIA, GLAXOSMITHKLINE AND ALCATEL LUCENT
RECONCILIATION OF EQUITY
(in EURm for NOK, £m for GSK and $m for ALU)
DECEMBER 31, 2006 for NOK and ALU
DECEMBER 31, 2005 for GSK

	Nokia	GlaxoSmithKline	Alcatel Lucent
Capital attributable to equity holders under IFRS	11986	7311	20,446
U.S. GAAP adjustments:			
Amortization and impairment of intangible assets	(109)		
Amortization and impairment of goodwill	456	17976	5,850
Property, Plant and Equipment		33	
Restructuring Plans		65	16
Sale and lease-back transactions			(323)
Acquisition and disposal of product rights		12065	
Write-off of in-process R&D acquired			
Investments		576	
Pensions	(276)	1294	1,105
Development costs	(102)		(192)
Share Issue Premium	143		
Share-based compensation expense	(143)		
Derivative instruments and hedging		(33)	(1,109)
Tax benefits on exercise of stock options			
Other differences	29	139	3
Deferred tax effect of US GAAP adjustments	146	4531	(346)
Total Stockholder's Equity under U.S. GAAP	12112	34282	25,450
Percent Change	1.05%	368.91%	24.47%

Chapter #5
Further Investigative Analysis of GSK and ALU

GSK and ALU Financial Performance Elements

Based on the results from the previous chapter's examination of difference that IFRS and U.S. GAAP had on selected ratios of income and equity for NOK, GSK and ALU, this chapter has been constructed to show a more in-depth analysis of those interesting results. The two companies that have been selected are GlaxoSmithKline and Alcatel Lucent. The following tables show key financial performance elements of GSK and ALU. These elements will be used to compute the nine ratios of investors and creditors, and analyze the affect they will have on these users' decisions.

GlaxoSmithKline	Financial Information at December 31, 2005					
	(in £ millions)		U.S. GAAP	IFRS		
Required Information			2006	2006	DIFF	% Change
	Current Assets		22664	13177	(9487)	(41.86%)
	Current Liabilities		16359	9511	(6848)	(41.86%)
	Total Liabilities		25425	19628	(5797)	(22.80%)
	Total Equity		34282	7570	(26712)	(77.92%)
	Cash Provided by Operations		5751	5958	207	3.60%
	Average Total Liabilities		25425	19628	(5797)	(22.80%)
	Net Income		3336	4816	1480	44.36%
	Interest Expense		380	381	1	0.26%
	Tax Expense		1415	1916	501	35.41%
	Preferred Stock Dividends		0	0	0	0.00%
	Average Common Shares Outstanding		57	57	0	0.00%
	Stock Price Per Share		50.80	50.80	0	0.00%
	Cash Dividends Declared on Common Stock		2390	2390	0	0.00%
	Average Common Stockholder's Equity		34282	7570	(26712)	(77.92%)

Alcatel Lucent	Financial Information at December 31, 2006					
	(in € millions)		U.S. GAAP	IFRS		
Required Information			2006	2006	DIFF	% Change
	Current Assets		16486	16211	(275)	(1.67%)
	Current Liabilities		11684	12175	491	4.20%
	Total Liabilities		25862	25381	(481)	(1.86%)
	Total Equity		19284	15123	(4161)	(21.58%)
	Cash Provided by Operations		168	351	183	108.93%
	Average Total Liabilities		25862	25381	(481)	(1.86%)
	Net Income		(590)	(176)	414	(70.17%)
	Interest Expense		222	136	(86)	(38.74%)
	Tax Expense		42	71	29	69.05%
	Preferred Stock Dividends		0	0	0	0.00%
	Average Common Shares Outstanding		1449	1449	0	0.00%
	Stock Price Per Share		14.22	14.22	0	0.00%
	Cash Dividends Declared on Common Stock		0	0	0	0.00%
	Average Common Stockholder's Equity		19284	15493	(3791)	(19.66%)

Ratio Analysis for GSK and ALU

The current ratio for GSK and ALU was not too greatly changed from U.S. GAAP to IFRS. Under U.S. GAAP, with both companies, current assets were reported higher, but for GSK, current liabilities were also recorded higher, which made their current ratio the same. However, ALU's current liabilities were reported lower under U.S. GAAP, which created a larger difference between current assets and current liabilities, thus a larger current ratio resulted. Because of this change in current assets and current liability accounts, investors and creditors will need to look more at the individual items that make up current assets and liabilities, rather than using a quick computation. If this is theoretically too time consuming, the users must just rely on their results and investigate only if the computation violates debt covenants or other contract provisions.

	GSK	ALU
U.S. GAAP: Current Assets	22664	16486
Current Liabilities	16359	11684
Current Ratio	1.39	1.41
IFRS: Current Assets	13177	16211
Current Liabilities	9511	12175
Current Ratio	1.39	1.33

Debt-to-Equity for GSK triples under IFRS compared to U.S. GAAP, and it also increases for ALU as well. Whether that is a good or a bad thing is situational, but in this instance, GSK's large increase could be alarming. If these companies were required to maintain a debt-to-equity ratio of 2, then GSK could be in trouble. Under this circumstance, GSK's creditors could increase the interest rate from 5% to 8%, make the loan become due as of now or decrease the amount there were going to lend them from $150,000 to $100,000. Regarding ALU, their .34 increase may not seem as big of a deal, but had their U.S. GAAP ratio have been 1.68 and then their IFRS ratio increased .34, then they would be in the same situation with their creditors as GSK. What this means is creditors may have to adjust their criteria to allow for a larger debt-to-equity ratio under IFRS, than they did with U.S. GAAP. If they do not adjust their criteria, they will risk loaning to risky companies, or rejecting healthy ones.

	GSK	ALU
U.S. GAAP: Total Liabilities	25425	25862
Total Stockholder's Equity	34282	19284
Debt-to-Equity Ratio	.74	1.34
IFRS: Total Liabilities	19628	25381
Total Stockholder's Equity	7570	15123
Debt-to-Equity Ratio	2.59	1.68

Although it was stated with the current ratio that GSK's current assets and current liabilities increased proportionately with the change to U.S. GAAP, that is not to say there is not a big difference between the IFRS to U.S. GAAP amounts. Working Capital nearly doubles for GSK under U.S. GAAP. This may initially be tricky for creditors and investors to spot, since GSK's current ratio hardly changed, but this could prove to be a more useful ratio under IFRS, than it is under U.S. GAAP. It is mainly used to show a positive trend of working capital, which is used to cover short-term maturing debt and the company's next years operating expenses, but with U.S. GAAP to IFRS reconciliations, it can add more detail to the current ratio's results. As for ALU, where their current ratio increased, their working capital only changed slightly.

	GSK	ALU
U.S. GAAP Current Assets	22664	16486
Current Liabilities	16359	11684
Working Capital	6305	4802
IFRS: Current Assets	13177	16211
Current Liabilities	9511	12175
Working Capital	3666	4036

GSK and ALU get the opposite results for cash debt coverage than they did with current ratio. With this ratio, ALU is not affected much by U.S. GAAP or IFRS, and remains around a low 1%. This means no matter what accounting system is used, ALU's operations are not looking too good, nor are they generating enough cash flow from operation to cover their liabilities. GSK however, has a better ratio under IFRS. The commonality between these two companies is that they both yield better operating cash flows under IFRS and both have a lower amount of total liabilities under IFRS. Because of both these items, their cash debt coverage looks better and GSK looks like a healthier company to creditors under IFRS.

	GSK	ALU
U.S. GAAP: Operating Cash Flows	5751	168
Total Liabilities	25425	25862
Cash Debt Coverage Ratio	23%	.6%
IFRS: Operating Cash Flows	5958	351
Total Liabilities	19628	25381
Cash Debt Coverage Ratio	30%	1.3%

As with the cash debt coverage ratio, GSK looks very healthy with the times interest earned ratio under both U.S. GAAP and IFRS. Any investor or creditor would be happy with 13.5 or 18.67, and a drastic interest expense or difference in EBIT would have to occur to convince users otherwise. However, ALU is now the alarming one with this ratio. In both instances, they have a very low ratio, which could potentially foreshadow bankruptcy. Under U.S. GAAP, ALU results in a large loss, but under IFRS, they have a small amount of income. This increase in earnings, combined with a decrease in interest expense allows them to have a positive ratio under IFRS, but it is still a frightening one. Since interest plays a large part in creditor's decisions, companies will receive a benefit from this ratio because IFRS creates a better looking times interest earned ratio. It makes good ratios look great, and struggling ratios look somewhat better.

	GSK	ALU
U.S. GAAP: EBIT	5131	(326)
Interest Expense	380	222
Times Interest Earned	13.50	(1.85)
IFRS: EBIT	7113	31
Interest Expense	381	136
Times Interest Earned	18.67	.23

Earnings per share greatly changed between U.S. GAAP and IFRS, even though the denominator stayed the same. The numerator, however, is affected very much by the different accounting methods, and is shown by the large variance below. Both companies report better income for IFRS, and thus both companies have better EPS under IFRS. This means that investors will be happier with EPS under IFRS. GSK goes from almost 59 under U.S. GAAP all the way to almost 85 with IFRS. That is an unbelievable difference. For this reason, EPS could become unreliable as a dominant ratio to use because every company will look better under IFRS. This will lead individual investors to either have a stricter boundary for EPS, or a different ratios may take the prominent place of EPS.

	GSK	ALU
U.S. GAAP: Net Income Available to Common Stockholder	3336	(590)
Common Stock Outstanding	57	1449
Earnings Per Share	58.84	(.41)
IFRS: Net Income Available to Common Stockholder	4816	(176)
Common Stock Outstanding	57	1449
Earnings Per Share	84.94	(.12)

Since EPS under IFRS made the companies look so much better, the P/E ratio has the opposite effect. The numerator is now the stable component and the EPS is higher under IFRS, meaning the P/E ratio will be lower under IFRS. In theory this is correct, and in the table below it can be seen. This means that as a result of investors accepting higher EPS they will have to account for lower P/E ratio. As stated previously in Chapter 2, the P/E ratio has the ability to overreact to news, causing the price of the share to be inflated, or investors often buy the stock at a higher price then it is worth in hopes of the company increasing productivity. With IFRS, P/E ratio can potentially overreact to news even more so because EPS will be higher and earnings will be reported higher. A negative ratio will continue to be a bad sign, but a ratio between 0 and 1 will become more acceptable under IFRS than it was with U.S. GAAP.

	GSK	ALU
U.S. GAAP: Stock Price per Share	50.80	14.22
Earnings Per Share	58.84	(.41)
Price/Earnings Ratio	.86	(34.92)
IFRS: Stock Price per Share	50.80	14.22
Earnings Per Share	84.49	(.12)
Price/Earnings Ratio	.10	(117.07)

IFRS or U.S. GAAP does not heavily affect the payout ratio since dividends are so arbitrarily decided. It is difficult to use dividends to predict growth, to evaluate profitability or suggest success since every company has a different dividend policy. U.S. GAAP and IFRS do not necessarily change the amount of dividends to common shareholders, but the two systems do change the amount of income those dividends are compared to. As discussed earlier, income is reported higher under IFRS for GSK, so investors would expect a lower payout ratio. Higher payout ratios will become more common during a change from U.S. GAAP to IFRS because companies will be reporting higher earnings, and some companies base dividends off earnings. Since companies will no longer be required to disclose their U.S. GAAP earnings, higher dividends against higher income may be the result.

	GSK	ALU
U.S. GAAP: Dividends to Common Stockholders	2390	0
Net Income	3336	(590)
Payout Ratio	.71	0
IFRS: Dividends to Common Stockholders	2390	0
Net Income	4816	(176)
Payout Ratio	.49	0

It is apparent that return on equity is another ratio where IFRS prevails above U.S. GAAP. It has already been noted that income is higher, but it has not been noted that equity is lower with IFRS. Since U.S. GAAP reports higher amounts of equity, and lower amounts of income, the return on equity is decreased. With GSK, an astonishing 64% return under IFRS is decreased to a troubling 10% under U.S. GAAP. What makes it even more of a difference is that the average return for the Drug Manufacturing Industry is 16%. This means GSK went from looking really good, to underperforming its industry. Many industries that conduct a lot of research and development or acquire a lot of goodwill will have this particular ratio affected. Investors and creditors will more carefully have to compare companies against industry averages and possibly double their U.S. GAAP return on equity requirement to achieve a stricter IFRS return on equity.

	GSK	ALU
U.S. GAAP: Net Income	3336	(590)
Total Stockholder's Equity	34282	19284
Return on Stockholder's Equity	.10	(.03)
IFRS: Net Income	4816	(176)
Total Stockholder's Equity	7570	15493
Return on Stockholder's Equity	.64	(.01)

	Better Under U.S. GAAP	Better Under IFRS
Current Ratio: GSK	N/A	N/A
Current Ratio: ALU	X	
Debt-to-Equity: GSK	X	
Debt-to-Equity: ALU	X	
Working Capital: GSK	X	
Working Capital: ALU	X	
Cash Debt Coverage: GSK		X
Cash Debt Coverage: ALU		X
Times Interest Earned: GSK		X
Times Interest Earned: ALU		X
Earnings Per Share: GSK		X
Earnings Per Share: ALU		X
Price- Earnings Ratio: GSK	X	
Price-Earnings Ratio: ALU	X	
Payout Ratio: GSK	X	
Payout Ratio: ALU	N/A	N/A
Return on Equity: GSK		X
Return on Equity: ALU		X

The above table summarizes the analysis for this chapter. It emphasizes IFRS and U.S. GAAP differences, especially since there is a correlation with these two companies. There does not appear to be one dominant accounting system, but there does seem to be similarities between ratios that look better under one system than another.

Chapter #6
Statement of Opinion

I have come to a few basic opinions regarding two main topics discussed. In regards to the U.S. converging to IFRS, it is apparent that there is much progress to be made. The intention of the IASB and FASB's joint venture is to come together and create a single set of accounting standards that can be relied on by all users to fairly represent the economic realities of a business. If so many controversial standards continue to exist between U.S. GAAP and IFRS, IFRS will not be fully relied on by external users. U.S. GAAP is looked upon as a strict, rules based set of accounting standards; while IFRS is seen as a more principles based set of standards that is criticized for being worded too loosely. This is one reason why users of U.S. GAAP are reluctant to adopt or converge to IFRS any time soon.

Regarding the affect that a convergence would have on financial statement information, it is apparent that many ratios and accounts are affected. According to my limited research, U.S. GAAP records higher amounts of current assets, lower amounts of current liabilities and higher equity than IFRS. However, IFRS allows for better-looking net income and cash flows from operations, and lower amount of total liabilities. Creditors and investors will have to respond to this convergence by adjusting their criteria to reflect these adjustments. This will take place by increasing the expectation of ratios involving net income and operations, but ratios involving balance sheet accounts will have decreased expectations. In other words, creditors and investors will be willing to accept lower current ratios, higher debt to equity ratios and lower P/E ratios. Additionally, industries involving certain aspects, such as R&D, will have their criteria adjusted from the beginning of the convergence because they know R&D is capitalized with IFRS but expensed with U.S. GAAP. Other consistencies within industries will become evident throughout the convergence process and further research in this area will draw a stronger correlation.

Overall, I anticipate that creditors and investors will have to be somewhat flexible during the first couple years of convergence. It will eventually be necessary for external users to re-evaluate their criteria for investments and loans, but until they have a few years worth of IFRS information to work with, they will be stricter with their money in order to avoid reckless, ill-informed decisions.

›endix: Figure 1

IAS/IFRS Number:	Reconciling Entries in the 20 F Filings:			
Consolidated Financial Statements- IAS 27	▪ Includes differences in the methods used to account for a business combination, the recognition and determination of purchase consideration, and the measurement and recognition of goodwill, negative goodwill, In Process R&D and other intangible assets arising in a combination.	▪ Effect on minority interest is different and is listed in equity section under IFRS.	▪ Foundations are consolidated under U.S. GAAP, but not under IAS.	
Impairment of Assets- IAS 36	▪ The reconciling entries relate to how impairment losses are measured and the reversals of impairment losses.	▪ IFRS generally allows certain intangible assets to be capitalized while U.S. GAAP does not.	▪ Impairment test: one-step test comparing book value and value- in-use under IAS; two-step approach under U.S. GAAP.	▪ Recoverability of previous impairment losses is allowed under IAS; not allowed under U.S. GAAP.
Income Taxes- IAS 12	▪ Reconciliation entries arise from differences in IFRS 12 and SFAS 109.	▪ For changes in exchange rate or indexing for tax purposes IAS requires deferred taxes on these items; U.S. GAAP does not.	▪ For changes in statutory tax rates, the effect is recognized in income for U.S. GAAP, including effect for transactions originally recognized in equity; IAS does not allow in income the effect related to transactions directly recognized in equity.	▪ Unrealized profits on intercompany transactions are eliminated: IAS bases deferred taxes on local tax rates of buyer; U.S. GAAP uses the local tax rate of the seller.
Property, Plant and Equipment- IAS 16	▪ Reconciling entries generally arise from revaluation of assets, depreciation, and gain or losses on revalued property.	▪ IFRS allows the writing up of assets after a write down; U.S. GAAP does not.	▪ For dismantlement costs, the discounted provision is capitalized and depreciated under IAS; accrue liability and expense over useful life under U.S. GAAP.	▪ Preproduction costs capitalized under IAS; expensed under U.S. GAAP.
Employee Benefits- IAS 19	▪ While the general principles governing IFRS and SFAS are the same, reconciliation entries arise because of methodological	▪ For the discount rate, IAS uses average long-term rate; U.S. GAAP uses the rate at which obligations could currently be settled.	▪ For refund of pension insurance received in cash and future credits, the entire "refund" is income under IAS; only cash received is income under U.S. GAAP.	▪ For overfunding of pension plan, the amount is an asset under U.S. GAAP; subject to impairment test under IAS.

	differences such as the recognition of prior service costs, use of the corridor tests, recognition of transitional obligation and the recognition of actuarial gains and losses.			
Provisions, Contingent Assets and Contingent Liabilities- IAS 37	▪ Differences exist in the measurement and timing of when contingent items are recognized under IFRS and U.S. GAAP.	▪ Costs accrued previously under IAS; accrued in current period under U.S. GAAP.	▪ For provision of rehabilitation costs, the discounted liability recognized under IAS; undiscounted liability applied incrementally is recognized under U.S. GAAP.	▪ For compensated employee absences, it is accrued as a liability under U.S. GAAP and (new) IAS standard, but differences persist.